

State of Washington
Department of Labor and Industries
2006 Supplemental Decision Package

Decision Package Code/Title	FR	New Technology to Combat Fraud
Budget Period	2005-07	2006 Supplemental Budget
Budget Level	PL	Policy/Performance Level

Recommendation Summary Text .

Preventing fraud and abuse in the workers' compensation system is one of the Department of Labor and Industries' highest priorities. The agency's efforts are hampered by an antiquated audit computer system that prevents performing more audits and collecting unpaid premiums.

The improvements in this package will replace the decade-old Field Audit Enhancement (FAE) software technology and create an audit referral tracking system. These improvements will reduce duplication of effort and manual entry time for L&I staff, a key part of meeting the agency's three-year goal of doubling the percentage of audited employers. The improvements will ease the electronic retrieval of taxpayer records, speed the screening process of referral information and allow tracking of audit results. This proposal would pay for contract programming and a project manager to complete this work in Fiscal Year 2007.

The cost to build and implement the new systems will be recovered in the first year of their use (Fiscal Year 2008), and will produce ongoing benefits.

Fiscal Detail:

Staffing (B6):

608-1 Accident Fund-State
609-1 Medical Aid Fund-State
TOTAL FTEs

FY 2006	FY 2007	TOTAL
0.0	0.7	0.3
0.0	0.7	0.3
0.0	1.3	0.6

Operating Expenditures:

608-1 Accident Fund-State
609-1 Medical Aid Fund-State
TOTAL Expenditures

FY 2006	FY 2007	TOTAL
0	587,403	587,403
0	587,402	587,402
0	1,174,805	1,174,805

Revenue (B9):

Fund/Major Group/Source
TOTAL Revenue

FY 2006	FY 2007	TOTAL
0	0	0
0	0	0

Package Description:

This request is a stand-alone piece of a multi-year plan to reduce fraud and abuse in Washington's \$1.5 billion annual workers' compensation system. This package is one step in doubling the percentage of employers audited annually from 2 percent to 4 percent. In order to accomplish this goal, the agency needs to update and streamline its outdated computer auditing system. The technology component of the plan will allow an additional 821 employer audits per year and lay the groundwork for future types of audits that will be more efficient and productive.

The improvements outlined in this package will bring L&I's computer auditing system up to date with current technology. The improvements will reduce duplication and manual entry time for staff. The improvements will expand the functionality of the computer auditing system to support alternative audit methods that are less time consuming for both employers and auditors. This budget package will also add components to track referrals. All those things are now done manually.

The new system will improve automated screening methods to reduce pre-audit research time and ensure auditors go to places where problems are most likely to exist. The new system will improve security of confidential data on the auditor's laptop computer. The package will permit field auditors to use conversion software to allow electronic retrieval of employer records that now requires manual photocopying.

Contract programming and one temporary project manager FTE are requested to complete this work by the end of Fiscal Year 2007. Starting in Fiscal Year 2008 a full time ITS4 will be needed for ongoing maintenance of the system.

The initial cost to build the new system will be recovered through increased revenue collections in Fiscal Year 2008. Beyond that, the new system will produce efficiencies that trim four hours from the time it takes each auditor to conduct an audit. That time savings will allow L&I to perform an additional 821 audits per year with an estimated \$4.2 million¹ in additional assessments. Assuming a 30 percent collections rate, this equates to \$1.26 million (\$4.2M x 0.30) in additional revenue per year

Combating fraud and abuse is what employers have repeatedly said they want L&I to focus on. At statewide rate hearings and in employer surveys, they have told L&I they feel at a competitive disadvantage when competing against companies that operate in the underground economy and avoid paying what they owe to the state departments of Labor and Industries, Revenue and Employment Security.

The chart below reflects our multi-year strategic plan of improving field audit processes. The plan provides a four percent penetration rate of employer accounts which enhances the sentinel effect of field audit in the employer community. Additionally, with the improved audit referral screening, the amount of completed debit² audits will increase from 50 percent to 53 percent.

¹ Difference between the forecasted assessments in Fiscal Year 2008 (\$17,687,000) and the forecasted assessment with the budget supplemental Fiscal Year 2008 (\$21,881,000)

² A debit audit is an audit that determines the employer owes additional premiums. Of all of the investigations performed 50 percent were found to owe premiums to L&I.

Implemented and Proposed Audit Strategies by Year

FY 2005 - FY 2008

Projected Percent of Employers by Year

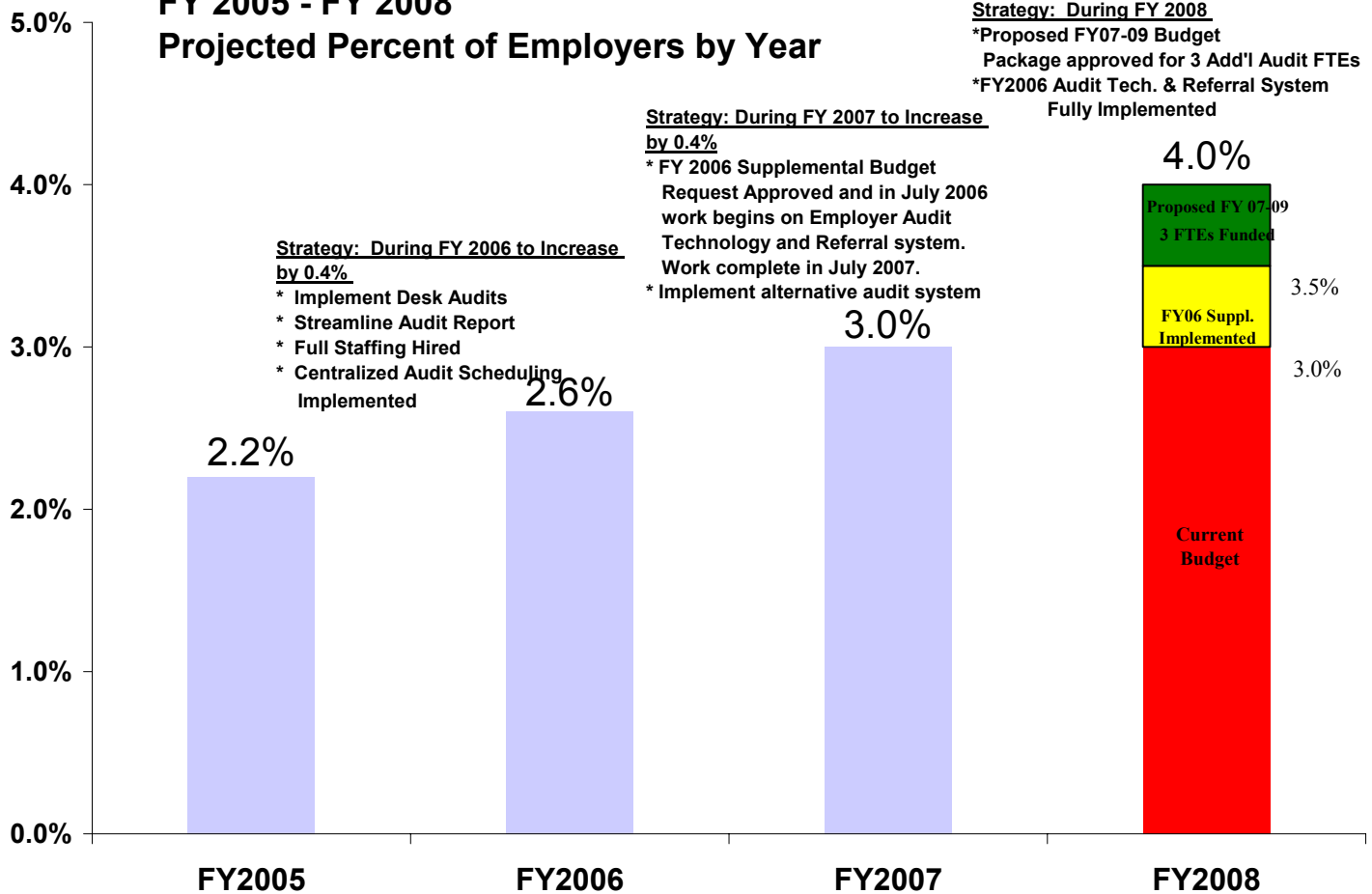
Strategy: During FY 2008

*Proposed FY07-09 Budget

Package approved for 3 Add'l Audit FTEs

*FY2006 Audit Tech. & Referral System

Fully Implemented



The workload impact of these changes equates to the following results:

	(FY 2005)	(FY 2006)	(FY 2007)	(FY 2008) ⁵	IMPACTS OF FY 06 BUDG SUPPL
Audit Penetration Rate	2.2 %	2.6 %	3.0 %	4.0 %	Included in FY 08: Impacts as a Result of FY 06 Suppl Budet ³
# of Completed Audits	3,668	4,258	4,913	6,550	5,734 ⁴
# of Employer Accts	163,752	163,752	163,752	163,752	163,752
\$ Premiums Assessed ⁶	\$14,000,000	\$15,328,000	\$17,687,000	\$26,881,000	\$21,881,000
\$ Premiums Recovered ⁷	\$4,200,000	\$4,995,000	\$5,306,000	\$8,064,000	\$6,564,000

³ Assumes 53 percent debit rate

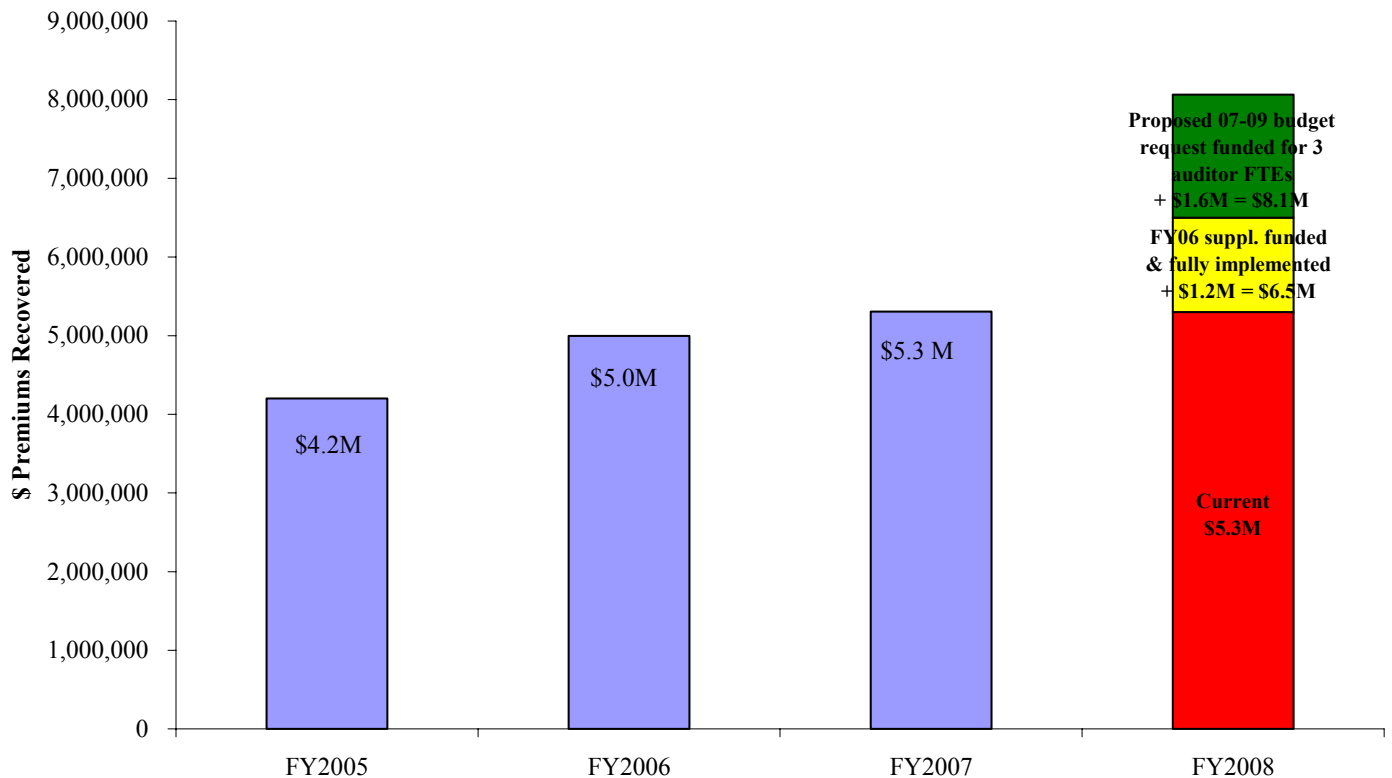
⁴ Assumes employer audit technology package, only

⁵ Includes three additional auditor FTEs

⁶ Completed audits x average audit value

⁷ Assumes 30 percent recovery rate

Projected Premiums Recovered FY 2005 - FY 2008



Background:

Audit results and increased employer compliance are a high priority with our stakeholders as evidenced by comments made by trade associations and employer groups in public hearings. An increased audit presence in the employer community will encourage voluntary compliance with the department's reporting rules.

The Department must act proactively to answer this challenge. One way the agency can achieve results and increased compliance is by doubling the percentage of employers audited annually from two percent to four percent over the next three years.

Problem:

One obstacle to achieving fraud and abuse prevention is that auditors now must operate with the current antiquated automated system. The system is slow, relies on varying levels of manual processes, and is not responsive to needs.

Using the current staff and systems L&I is only able to audit two percent of State Fund employers. This is not nearly a high enough percentage to deter fraud. In recent years, our stakeholders and customers have been clear in sending this message. L&I intends to double that number to ensure that employers who underpay or knowingly cheat the system are more likely to get caught. The department could achieve this in two ways:

- By hiring dozens of additional auditors, or
- Modernizing its computer system so that it is less labor intensive and provides more reliable information, thus giving the current audit staff the time it needs to perform more audits.

Proposed Solution:

Our proposed solution to upgrade and streamline the auditing system and create the new referral system will:

- Provide the most efficient use of resources needed to accomplish the stated goals of achieving a 4 percent employer account penetration rate and a 53 percent rate of debit audits.
- Streamline and improve support of audits by reducing the amount of data that needs to be entered manually.
- Simplify data collection and support the use of data obtained from the data warehouse.
- Support on-going system enhancements as well as the next generation of improvements. These will include:
 - Identifying employers who are most likely to owe premiums.
 - Creating a new type of on-line audit process that will be more efficient, productive, and less burdensome on employers.
 - Introducing technology that will reduce employer contact time with field auditors during audit engagements.

Specific benefits include:

1. Improved Audit Screening and Increased Audit Assessments

The new system will allow staff to view consolidated information from multiple sources. The information will be arranged to identify the probability of misreported premium liability. The presentation of the data will allow staff to gauge the level, or dollar value, of the misreporting. The information collected from various sources includes elements of fraud. This information will be structured to indicate those employers who are likely committing fraud or abusing the workers compensation system.

With limited audit staff, it's particularly important that the program focus its audit resources on employers and industries in which misreporting is the most severe. The new system will help staff to identify employers who owe the highest amount of premiums. Through improved audit screening, we expect to increase the percentage of debit-effect audits from 50 percent to 53 percent.

2. Increased Audit Efficiency

The manual entry of data will be significantly reduced with this system. Several software applications are included in this request which will facilitate the review and manipulation of employer's payroll data by auditors. Conversion software will allow the data to be imported to the audit system and captured electronically instead of photocopied and manually retyped. Business activity and payroll information reported to other state agencies will be included in each audit when it is assigned to the auditor.

Audits will be processed more efficiently, saving time and effort for both audited employers and agency auditors. These changes are projected to reduce the average time required for each audit by four hours. This will allow audit staff to produce 821 (414 field audits + 407 desk audits—see “Expenditure Calculations and Assumptions” for details) additional audits per year.

3. Payoff Within One Year

The costs of developing this system are more than offset by the annual increase in audit assessments and collections. The technology will pay for itself within the first year and provide a platform for additional improvements in the future which have the potential of even more revenue collection.

4. Remove Dependence on Aging Inadequate Technology

The current audit computer system is difficult to maintain and difficult to modify to suit current needs. The exchange of data between the audit system and the department's accounting system is performed with slow, batch processes that extend the time required to perform each assignment. The aged system is not stable, and at times “locks up”, sometimes causing a loss of data and hours of rework to be done.

The application was built using PC-based technologies that were acceptable over ten years ago but do not begin to meet today's standards for ensuring privacy and confidentiality of information. Replacing the application with a more secure system will protect against unauthorized access to medical records data and to social security and wage data that in the wrong hands could lead to identity theft.

Narrative Justification and Impact Statement

The expected results of this package are tied directly to the Priorities of Government:

- Improve the economic vitality of businesses and individuals (POG Result 6)
- Improve the quality and productivity of our workforce (POG Result 2)
- Improve the ability of state government to achieve its results efficiently and effectively (POG Result 11)

This package is tied to the following agency goals:

- “Level the playing field” for businesses.
- As a regulatory agency, ensure integrity by bringing businesses in the “underground economy” into compliance .
- Administer the premier workers’ compensation system in the nation, one that provides a high level of benefits and services at a cost employers and workers can afford.

Performance Measure Detail:

The incremental performance effects of this funding will begin in Fiscal Year 2008.

Performance Measure Changes:	Incremental Changes	
	<u>FY 2006</u>	<u>FY 2007</u>
1. Dollars collected from delinquent employers	N/A	N/A
2. Number of premium audits completed	N/A	N/A
3. Dollars identified as due from premium audits	N/A	N/A

Statement of Expected Results:

As stated, the agency expects to double its audit presence in the workplace and to significantly increase the debit dollars identified for collection. As such, the proposed system enhancements will allow audit staff to improve audit screening, increase audit effectiveness, and enhance revenue recovery.

Fiscal Year 2008 Improvements

Improved audit screening	Increase percentage of completed debit-effect audits from 50 percent to 53 percent.
Increased audit effectiveness	Produce 821 additional audits annually which would increase annual assessments by \$4.2 million. Decrease processing time by 4 hours per audit resulting in 15,316 additional productive staff hours or 7.4 additional FTEs (\$383,000 annual cost)
Increased revenues	\$1.26 million annually

Reason for change

- Outdated and unsupported technology
- Unsecured computer system
- Inefficiency of manual data entry
- Stakeholder feedback
- Lack of automated referral tracking system

Having this field audit replacement project funded first through the 2006 Supplemental Budget process makes sense. It allows for the agency to be prepared to process a greater volume of audits when these changes are completed. It also allows the agency to reduce information technology system risk, by dividing the project into components of manageable size and complexity.

Impact of the change on clients and services

Employers who pay, appropriately, will not be inconvenienced by audit actions.

Employers who currently pay what they owe will be less likely to find themselves competing against companies that cut expenses by regularly avoiding paying state taxes or failing to pay.

Moreover, this decision package will help L&I fulfill a commitment to employers who accurately report hours worked and pay what they owe to the workers' compensation system as well as reduce the time an employer must spend with an auditor. Further, it will allow L&I auditors to more effectively target employers who under report or operate in the underground economy. Such employers will be subject to more scrutiny and will be required to pay their fair share of workers' compensation premiums.

Other impacted programs/divisions/regions

L&I programs workloads will be impacted due to the increase in audits.

- Detection and Tracking Unit (DTU)
 - Projected audit support workload will double.
 - Anticipate requesting an additional FTE in a future decision package to support workload increase.
- Collections
- Anticipate a one percent increase in workload.
- Firm Appeals
- Project an additional 120 reconsideration or appeals.

The Attorney General Office's workload is expected to increase by 0.13 FTE starting in Fiscal Year 2008 and by 0.25 FTE in Fiscal Year 2009 and thereafter due to the projected increase in audits.

The Board of Industrial Insurance Appeals (BIIA) may experience an increase of 20-40 appeal cases annually.

Relationship to capital budget

None

Required changes to existing RCW, WAC, contract or plan

None

Alternatives explored by agency

We researched acquiring software commercially or from another state. A survey of existing commercial software or state-developed software yielded minimum returns. Most commercially available fraud prevention and non-compliance software focuses on provider and injured-worker fraud versus employer fraud.

We also looked at other Washington State agency programs, such as Department of Revenue, to determine the usability of these programs to the agency's audit function. Although DOR's system does have many great features, it is not compatible with the tracking of employer payroll hours as is required by L&I industrial insurance tracking.

Hiring additional field and desk auditors was also explored as a means to achieve the projected four percent account penetration rate and achieve the increase in debit audit production. Although the additional equipment costs would be one-time issues, payroll and benefits funding consequences would be recurring which makes this a lower return on investment on a long-term basis.

Consequently, none of these alternatives are feasible to achieve agency audit goals.

Budget impacts in future biennia

Future budget impacts include the hiring of one (1) ITS 4 FTE to support and maintain the new system(s) developed as part of this proposal. On-going hardware maintenance costs (\$168,000) and software maintenance agreements (\$75,800) are also assumed.

Implementing the field audit replacement system is an initial step in towards improving audit targeting and collections. A decision package is planned for submittal for the 2007-2009 Biennium with a cost of approximately \$4 million to \$5 million that will further advance efforts to detect and target fraud. The subsequent package will focus on fraud targeting and detection, as well as improving interagency sharing of data and support for alternative audits.

The 2007–2009 Biennial funding request will include costs to implement the following additional enhancements:

- **Fraud targeting and detection** Improvements will allow the agency to more effectively determine and target fraudulent employers for audit. Currently the agency data for employers is scattered across many systems. Data obtained from other agencies is not easy to compare with

L&I information. Enhancements will support consolidating employer data as well as developing improved data analysis and targeting features. This should ultimately result in an increase in the percentage of debit audits.

- **Litigation tracking** Improvements will provide management information required to effectively and efficiently manage employer accounts self-referred to litigation. It will track reconsideration requests and the appeals process.
- **Alternative audits** Improvements will expand system support for alternative audits including phone audits, desk audits, and mail audits.
- **Additional Audit FTEs** to fully support the plan.

Distinction between one-time and on-going costs

One time costs of \$810,929 represent the expenses related to:

- Project Manager and ITS 4
- Technology for the new system including contractor development
- Design and implement of a new Field Audit application
- Referral tracking system
- Data extracts from the L&I data warehouse

In future biennia, additional appropriation authority will be needed to cover legal expenses incurred by the Attorney General's Office to litigate fraud cases. These costs are estimated to be an additional \$90,060 in the 2009 -11 Biennium due to the phase in start up costs during Fiscal Year 2008.

Effects of non-funding

- The opportunity cost of \$6.3 million (\$1.26 million per year x 5 years) in gross revenues will be lost over the next five years.
- Duplicate entries into the existing system would continue as well as manual entries by staff which are time consuming. This would result in auditors not being as efficient as they could be and less audits being produced.
- Newly developed processes such as our alternative audit system (mail, phone and self audits) will not be performed efficiently and take more staff time to complete.
- Our audit referral and tracking process will not be able to process and adequately identify audits to the field auditors to increase audit penetration.
- L&I will fail to reach the projected four percent employer account penetration rate.
- Inefficiencies of operating with existing outdated Field Audit Enhancement (FAE) software will continue.

Expenditure Calculations and Assumptions

Increased productivity	<ol style="list-style-type: none"> 53 Field Audit FTEs x 2,080 available hours/year = 110,240 hours available. 110,240/3,829 audits completed in Fiscal Year 2005 = 28.79 hours per audit. Four hours reduction in audit time is achieved as a result of improved technology and streamlining audit processes = 24.79 hours per audit. 110,240 hours available divided by 24.79 FTEs = 618 audits. Assumes that desk audits take half as long as field audits. Also assumes that one third of these saved hours will be used for desk audits. 618 field audits x 24.79 = 15,316 hours to allocate field and desk audits. Assumes two thirds of these saved hours will be used to conduct additional field audits. 15,316 hours saved through system efficiency x 0.67 = 10,261. 10261/24.79 = 414 field audits. Assumes desk audits will be twice as productive as field audits. 15,316 x 0.33 = 5,054. 5054/12.40 = 407 desk audits. Total audit productivity increase = 414 + 407 = 821 audits per year
Increased audit efficiency	821 additional audits annually which would increase assessment by \$4.2 million.
Reduce time to process an audit	Decrease processing time by four hours per audit resulting in 15,316 additional productive man-hours which is equivalent to 7.4 additional FTEs.
Increased revenues	\$1.26 million annually starting in Fiscal Year 2008.

	FY 2006	FY 2007	TOTAL Biennium	Biennium 2007-2009	Biennium 2009-2011	TOTAL
FTEs	0.0	1.3	0.7	1.0	1.0	0.9
Objects of Expenditure:						
A - Salary and Wages	0	80,053	80,053	104,424	104,424	288,901
B - Employee Benefits	0	23,736	23,736	30,962	30,962	85,660
C - Personal Service Contracts	0	0	0	4,750	6,250	11,000
E - Goods and Services	0	849,767	849,767	128,123	155,832	1,133,722
G - Travel	0	689	689	1,102	1,102	2,893
J - Capital Outlays	0	220,560	220,560	243,800	243,800	708,160
TOTAL Expenditures	0	1,174,805	1,174,805	513,161	542,370	2,230,336
Funds:						
001-General Fund	0	0	0	0	0	0
02V-PSEA	0	0	0	0	0	0
095 Electrical	0	0	0	0	0	0
608 Accident Account	0	587,403	587,403	256,581	271,186	1,115,170
609 Medical Aid Account	0	587,402	587,402	256,580	271,184	1,115,166
Other (specify fund code)	0	0	0	0	0	0
TOTAL Funds	0	1,174,805	1,174,805	513,161	542,370	2,230,336

	2005-07		2007-09		2009-11	
	FTEs	Dollars	FTEs	Dollars	FTEs	Dollars
Project Manager	0.50	\$109,595				
ITS 4	0.13	\$30,372	1.0	\$163,426	1.0	\$163,426
Indirect Cost		\$9,978		\$13,442		\$13,442
Asst. Attorney General				\$92,493		\$121,702
Personal Vendor Services		\$72,000				
Purchased Vendor Services		\$750,960				
Hardware		\$109,000		\$168,000		\$168,000
Software		\$92,900		\$75,800		\$75,800
Total	0.63	\$1,174,805	1.0	\$513,161	1.0	\$542,370

L&I Administration and IS Allocation

In addition to the direct costs estimates with this decision package, L&I included funding to cover agency wide indirect costs for the Administrative Services and Information Services programs. A rate of 7.3 percent in Fiscal Year 2006 and at rate of 7.6 percent in Fiscal Year 2007 and beyond is applied to cost estimates for FTEs and the standard costs associated with the addition of new FTEs, the exception being the cost of equipment purchases. These indirect rates for the Insurance Services program are based on the cost allocation methodology adopted by L&I in 2003 (with the funding realignment approved in the 2004 Supplemental and the 2005-07 budgets) and the model update completed in July 2005.

Depending on the needs of the agency, activities covered by the indirect funding include the handling and processing of vendor payments and payroll; equipment purchase, delivery, inventory, storage and set-up; technical assistance to employees; desk-top and network support; internal IT systems support; contract administration; legislative services and public affairs; library; public disclosure; personnel and employee services; budget; accounting; facilities management; and other indirect support services functions.

Notes:

Hardware: (\$109,000, one-time and \$168,000/biennium, on-going)

- Five purchased PCs for Contract Staff @ approximately \$5,000 equates to a one-time cost of \$25,000.
- Based on the potential implications associated with accessing and retrieving data on the mainframe at Department of Information Services (DIS) it is estimated we will require an additional five MIPS (Millions of Instructions per Second)⁸ of mainframe storage capacity, on-going in subsequent biennia (after June 30, 2006). MIPS are purchased in blocks of 10 for

⁸ MIPS or Millions of Instructions Per Second is a technical term used to describe the the measurement of the processing power consumed from the mainframe. Each time some one accesses data or adds data to the mainframe database it is considered an "instruction." Examples of other types of instructions to the mainframe include: add a number, or get a piece of data, or write a response to a request for data, or each instruction to store a new piece of data. DIS charges agencies for each 10 MIP incremental increase in usage.

\$14,000/month. Therefore, the on-going cost associated with purchasing five MIPS equates to \$168,000/biennium.

Software: (\$92,900, one-time and \$75,800/biennium, on-going)

- We will need a report mining/data analysis tool such as Monarch. This particular software transforms structured text files (reports, statements, etc.) into a live database users can sort, filter, summarize, graph and export to other applications such as Excel or Access. Based on the Monarch price list, we are estimating that we will require approximately \$50,000 one-time cost (100 licensing agreements at approximately \$500/agreement) and \$20,000/biennium for continued licensing, support, upgrades, and maintenance.
- We will need to purchase desktop security. Based on the price of one security software provider/service (PGP® Desktop Professional 9.0), we are estimating a \$27,900 one-time cost (100 licensing agreements at approximately \$279/agreement) and \$25,800/biennium for continued licensing, support, upgrades, and maintenance.
- We will need to purchase QuickBooks Pro. This application is used by many employers and therefore the audit staff will need to have their own copy in order to be able to capture and reformat the data for use with the new system. Based on the price identified at www.Quickbooks.com we are estimating \$15,000 one-time cost (100 licensing agreements at approximately \$750 for 5 licenses) and \$30,000/biennium for continued licensing, support, upgrades, and maintenance.

FTEs	Responsibility
Project Manager	The 1-year term project management position provides overall management and operational direction of the project. Responsibilities include contractor oversight and accountability, deliverable definition and coordination, project scheduling and tracking, and management reporting including regular status reporting. The person hired into this position will work closely with the project's Executive Sponsor, Executive Steering Group and other project stakeholders to achieve on time, within budget deliverable completion and overall project success.
ITS 4 (1), On-going	Will work in the information technology area, to participate in the knowledge transfer of the new systems so that they will be able to support, maintain, and enhance in future biennia. As with other applications within L&I, this person will be the primary point of contact to ensure the system is operational and provides the necessary functionalities for the end-users.

Personal Services Contracts - 720 hours (@ billing rate of \$100/hr) for analysis and design and infrastructure and architectural related services associated with the various system enhancements.

Purchased Service Contracts - 9,387 hours (@ billing rate of \$80/hr) for software development, programming services, testing, and implementation.

These hours/costs are broken down as follows (See Attached Overview and Scope Document for Detail):

Function	Hours	\$/hour
Referral Tracking:	832	\$80
Support for Pre Audit Review	1,510 200	\$80 \$100
Support for Field Audit Review	5,160 520	\$80 \$100
Support for Self Audit or Other New Audit Types	240	\$80
Management Reporting and Workload Tracking	1,000	\$80
Other Requirement Areas (Security, Archiving, etc.)	645	\$80
Totals	10,107	\$822,960

Estimation Assumptions

- Hour estimates based on experience gained in multiple systems implementations.
- Purchased services and personal services calculated at \$80 and \$100 per hour respectively based on the need for expertise in Internet-based technology and system interface development.